

BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

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JULY 1951

New Capital Needed in Soil Improvements

Some Investment Justified Even During Inflation

- A practical way to increase farm production.
- The investment may reach \$40 per acre, but it usually pays well.
- A soil improvement program provides a sound base for credit.

Nearly a fifth of the nation's cropland lies within Seventh District states. Included is a lion's share of the best land available. The growing demand for farm products dictates that this natural resource be used in ways which will assure a continuing record production.

Some farmers have successfully stepped up the productivity of their land by making additional investments in soil improvements. Much more land would respond favorably to such action, with beneficial results to farmers and society generally. But in an economy plagued by inflation it must be recognized that new capital investments give an additional push to the already strong upward pressure on prices. Nevertheless, increased production is needed. The immediate problem is to achieve it with the least inflation possible.

There is a longer-run consideration also. The United States population now exceeds 152 million, nearly one-fourth more than in 1930. The increase in the past decade has been especially rapid, nearly two million a year. Thanks to the improved technology which helped to increase farm production by nearly two-fifths since 1930 there is little immediate concern about meeting domestic needs for food and fiber. It is apparent, however, that greater future demands will result from increasing population and rising levels of living in both the United States and the world generally. If wise management of soil resources is to be achieved, it will be necessary to invest in practices that will: (1) minimize erosion; (2) keep the soil in good physical and biological condition; and (3) provide adequate plant food elements.

Needed Improvements Will Vary

Specific measures needed, as well as costs and size of investments, will vary from farm to farm and by areas depending upon soil type, topography, and related factors. Most of the level to gently rolling land in the District would benefit greatly from applications of limestone and fertilizer and the use of proper crop rotations. However, the more rolling and hilly areas will require more intensive soil management practices such as contouring, strip-cropping, terraces, waterways, dams, and

structures of various kinds. In addition, these practices should be supplemented by those beneficial to the more level soils.

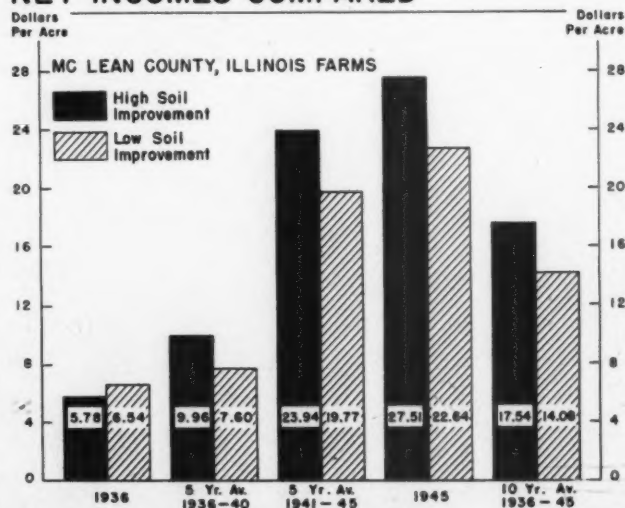
On farms requiring dams, tiling, and other structures, the cash outlay may be exceptionally high. Contouring and strip-cropping, however, require little or no cash outlay, but some farmers contend that these practices increase operating costs in excess of benefits. Detailed studies, however, do not support this view. In general, contouring and strip-cropping require little or no change in acres of cash crops. On the other hand, measures such as shifting part of the land from grain to hay and pasture decrease grain acreage and necessitate expenditures for seed, fertilizer, lime, and for livestock, fencing, and buildings. By and large, improving the soil on most farms increases the capacity for production of roughage-consuming livestock. Benefits derived, therefore, may depend largely upon the degree of efficiency with which livestock is handled. Reduced grain acreage, however, does not necessarily result in a permanent reduction in grain production since yields per acre increase in response to the improved soil management.

The Investment Pays

It is not possible to indicate the over-all amount of new capital investment needed to bring land already in farms to an optimum state of productivity. In most areas, however, it runs into substantial sums. The capital outlay required for a group of Northeastern Illinois farms in 1945-47, for example, was \$7,242 per farm or \$34 per

(Continued on Inside Back Cover)

NET INCOMES COMPARED



Sources: University of Illinois and U.S. Soil Conservation Service.

THIS MONTH'S COVER
Blast Furnaces at Gary Works
(Courtesy of Carnegie-Illinois Steel Corporation)

Korea Plus One Year

- Heavy private buying dominated the past year, driving prices to new highs.
- Record peacetime production dampened inflationary upsurge.
- Rising defense outlays a prime factor in the outlook.
- Higher taxes and effective credit control essential.

Since early March the American economy has been marking time, catching its breath from the second post-Korea buying wave, and pointing toward a renewal of inflationary pressures. From outward appearances, business activity has passed a peak — many prices have been trending downward and output of certain classes of consumer goods has been curtailed for lack of demand. Seldom before, however, has the handwriting on the wall stood out more clearly. The problem is not one of business recession. On the contrary, business and consumer income are likely to be boosted to new highs by the end of the year as defense spending rises sharply from present levels. Each new month is bringing additional cutbacks in the use of materials for the production of civilian goods so that the rearmament program may proceed unimpeded.

The Immediate Impact

On June 25, 1950, the Red hordes crossed the 38th parallel. Within a matter of days American contingents had been committed to action. Soon it became apparent that partial mobilization had become the order of the day. Military units in the United States were alerted for overseas duty, reservists were called back, and the President made an initial request for an additional 17 billion dollars for the armed services.

After a week or so of stunned surprise following the outbreak of hostilities many American businessmen and consumers decided "this is it." They reacted vigorously to the emergency by buying heavily of the items which they expected would be in short supply. Business firms stocked up on metals and metal products in anticipation of price rises or in an attempt to continue operations longer than the next fellow. Housewives raided retailers' inventories of coffee, soap, sugar, nylons, white goods, and other items which help make life pleasant, while their husbands began to question the adequacy of the

family car and the household's major appliances. As prices rose rapidly in response to this unprecedented demand, Congress took steps to control inflation and lay the groundwork for a mighty rearmament effort.

On September 7, 1950, President Truman signed the Defense Production Act and thereby acquired the right to fix prices and wages, allocate scarce materials, encourage industrial expansion and control certain types of credit.

In a series of executive orders the President delegated his new powers to various Government agencies old and new. "Alphabet soup" returned to Washington with the creation of the ODM, OPS, DPA, and NPA (in place of the OWM, OPA, and WPB of World War II fame). Staffing these agencies immediately became one of the important problems of the rearmament program. Clerical workers have not been in abundant supply, and businessmen and educators have been less willing to leave their jobs to accept key positions than they were in 1941.

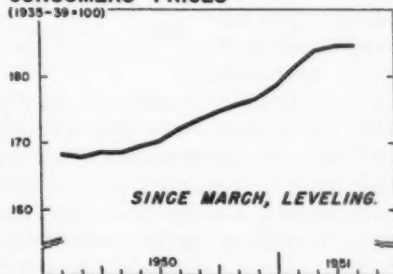
Making Way for Defense Production

Even before the Korean episode American business was operating at peak rates. Over 61 million persons were employed, and industrial production was at a peace time peak. In fact, resources were so fully employed that prices had been edging upward for some months. Nevertheless, the surge of private spending and ordering during the summer and fall of 1950 pushed industrial output up an impressive 10 per cent by the end of the

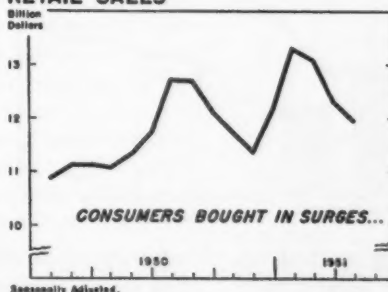
year. As defense contractors began to call for scarce materials, it became obvious that a system of priorities would be necessary. The newly formed National Production Authority (NPA) responded with the "Do" designation for orders connected with the rearmament effort.

By November, the North Korean aggression was crushed, and the campaign appeared to be in the mopping-up stages. Buyers relaxed and the atmosphere of

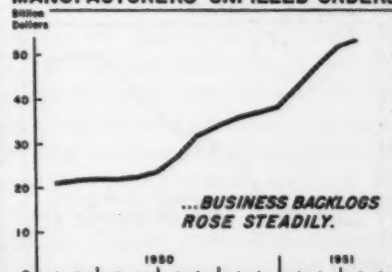
CONSUMERS' PRICES



RETAIL SALES



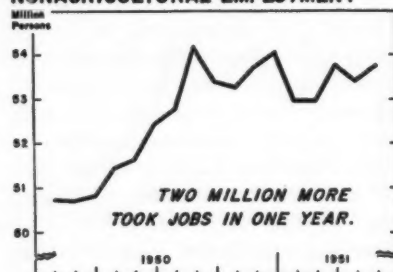
MANUFACTURERS' UNFILLED ORDERS



urgency surrounding the mobilization effort temporarily abated. Then suddenly, the entry of the Chinese Communists into the conflict created "an entirely new war."

The reverberations resulting from this new development surpassed in some respects those which occurred in July. Some Congressmen called for full mobilization.

NONAGRICULTURAL EMPLOYMENT



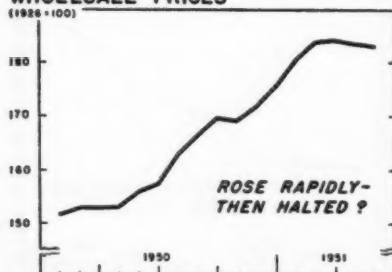
spree. Wholesale prices which had begun to level off started upward once again. In January, price and wage controls were imposed, and the Government tightened its control of strategic materials by restricting the amounts that could be used in some types of finished goods.

Inflation Halted In the Spring

At the time of the declaration of the National Emergency in December 1950 few observers would have predicted an abatement of inflationary pressures by the second quarter of the new year. Nevertheless, in March, wholesale prices reached a peak. (Certain spot commodity prices had been moving downward even earlier.) Why did the upward surge of prices halt at a time when the principal long-run inflationary force, defense spending, was only beginning to be felt?

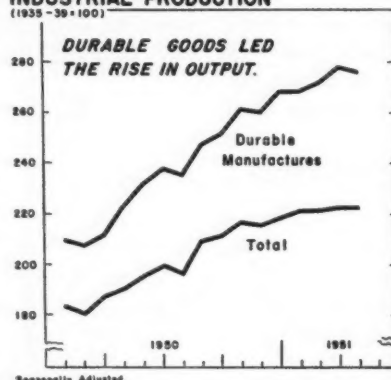
In the nine months following the outbreak of the Korean war total spending reached unprecedented levels. Government outlays for defense more than doubled. Personal consumption expenditures rose 10 per cent. Housing activity and business capital expenditures set new records. Business inventories rose over 20 per cent in dollar volume. This spending was made possible by peak corporate and individual income, supplemented by a record increase in borrowings and some liquidation of near-cash assets. In view of the heavy demand, it would not have been surprising if prices had risen even more.

WHOLESALE PRICES



The President asked for an additional 11 billion dollars for defense and declared the existence of a National Emergency. Toward the end of December consumers responded to the new crisis by embarking upon a second buying

INDUSTRIAL PRODUCTION

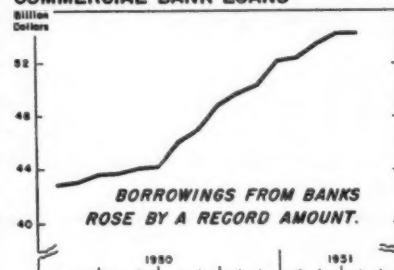


The wave of spending was checked by a combination of factors. Individual and business taxes were raised and an excess profits tax was enacted in the fall of 1950. As a result, Government revenues increased faster than expenditures and a record Treasury surplus of nearly seven billion dollars was

achieved in the first quarter. Restrictions placed upon consumer credit and mortgage lending on new homes began to have an important effect early in 1951. Price and allocation controls tended to reduce speculation

and alleviated the wage-price spiral. Reports from the battle field grew more encouraging. Most important, however, were the enormous quantities of finished goods which greeted shoppers when they sallied forth to "beat the hoarders." The record of the June 1950-March 1951 period is a tribute to the productivity of American business and the adaptability of management in dealing with problems of material shortages.

COMMERCIAL BANK LOANS



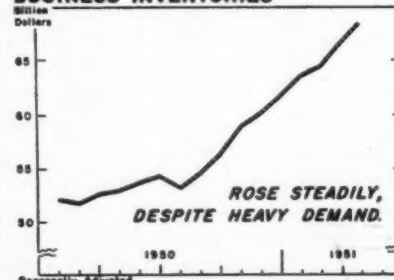
Defense Dollars Begin to Flow

The general outline of the rearmament program was set forth in the April 1 report of Charles E. Wilson, Director of Defense Mobilization. These basic goals presumably will not be changed significantly, barring serious deterioration of the international situation. By mid-1953 we are to have (1) plenty of modern equipment for our forces and those of our allies, (2)

"capacity to produce" 50,000 planes, 35,000 tanks, and large amounts of other defense items per year, and (3) an industrial plant capable of producing 15 per cent more goods. Within two years "our readiness to enter upon total mobilization should be sufficient; and production, in addition to meeting current military needs, should be adequate to support a civilian economy at or above pre-Korea levels."

Defense spending is now at a rate of over 30 billion dollars per year, double the figure for last June. By the end of the year these outlays are expected to have risen to a rate of 50 billion dollars

BUSINESS INVENTORIES



per year. A peak of about 70 billion should be reached in late '52. Currently, we are devoting 10 per cent of our total output to defense; at the highest point now foreseen, this proportion will reach 20 per cent.

The production task ahead is less burdensome than that of the last war, in both absolute and relative terms. In 1943 and 1944, war connected spending totaled about 90 billion dollars at a price level well below that of today. Military purchases accounted for 45 per cent of the total national product in those war years. Many important programs will be on a smaller scale than they were then: (1) no great shipbuilding program—naval or merchant—is planned, (2) munitions plants left over from World War II are being reactivated, (3) fewer military posts and air bases will be constructed, and (4) no totally new industries such as synthetic rubber or atomic energy will have to be built up. To meet the needs of the armed forces, procurement agencies are able to call upon a vastly expanded industrial plant and a larger, more efficient work force.

Since total output will continue to rise, particularly as new plants are put into operation, a large volume of goods will continue to be available for nonessential civilian purposes. Manufacturers of consumers durables will receive sufficient raw materials to produce more units than ever before except for top periods in recent years. The auto industry, for example, will be allowed enough steel to produce 2.4 million cars in the last half of 1951. Pre-World War II output averaged less than 3.5 million cars per year. Nevertheless, the reduction in the supply of durables from recent levels will pose a significant inflationary problem in view of high and rising individual income.

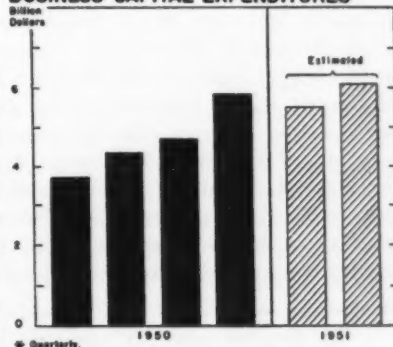
Price Controls Under Fire

The absence of price rises in recent months coupled with the slowness of defense production to get under way has encouraged certain spokesmen for industry and agriculture to urge that price and wage controls be scrapped. They believe that the enormous productivity of American business together with strong monetary controls, heavy taxation, and the

RESIDENTIAL CONSTRUCTION



BUSINESS CAPITAL EXPENDITURES*



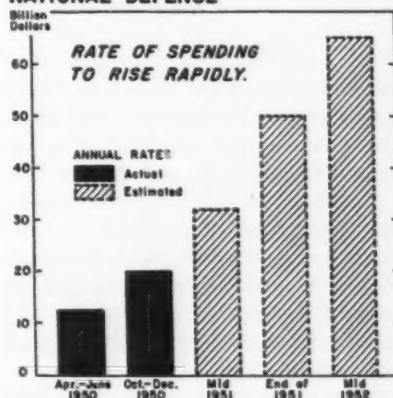
restriction of nondefense Government spending can do the job of holding prices down. Memories of the immense problems created by the direct controls of World War II and after, are still fresh in the minds of those responsible for production.

While the effectiveness of credit, wage, material, and price controls has been varyingly assessed, it is unlikely as a practical matter that nondefense spending can be reduced sufficiently or that a pay-as-you-go tax plan will be enacted. Inflationary pressures are very likely to reassert themselves later this year as the arms and capital expansion programs take an increasing volume of total output. These expenditures place additional purchasing power in the hands of consumers and business firms at the same time that the supply of finished civilian goods is reduced.

Arms production is already shoving consumer durable goods aside in significant proportions. Military equipment requires much larger proportions of certain types of materials, particularly metals, than is indicated by an over-all comparison with total output. Under the Controlled Materials Plan which becomes effective July 1 additional amounts of strategic materials will be allocated

to essential uses. Current regulations permit consumer goods fabricators to use only 70 per cent of the steel, 65 per cent of the copper, and 55 per cent of the aluminum in the third quarter of 1951 that they used in the average of the first two quarters in 1950. Residential construction is also being reduced substantially as a result of direct and over-all credit controls. Meanwhile, consumer income continues to rise.

NATIONAL DEFENSE



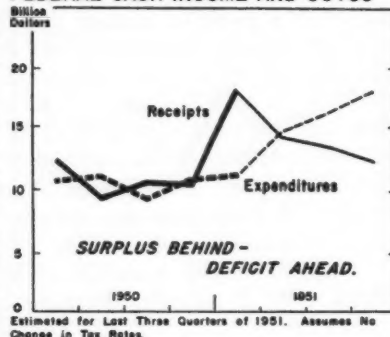
A Look Ahead

In the coming year, total spending is almost certain to exceed that of any previous 12 month period. Government expenditures, dominated by the defense effort, will increase steadily, and can be plotted with reasonable accuracy barring a significant change in the international picture. Business outlays for plant and equipment will be at record levels, but the rise from the current rate will be restrained by Government regulations forbidding less essential projects which require substantial quantities of strategic materials. The build-up of business inventories will be smaller than in the past 12 months, and may even give way to some liquidation, as a result of material allocations and cutbacks in civilian production. Consumer spending, by far the largest component of total demand,

is less predictable. Personal spending programs are more indefinite than those of business and Government.

Personal income is now at a rate almost 15 per cent above that of last June. A further substantial rise can be anticipated as additional persons are employed, longer hours are worked, and wage rates tend upward. If the increased income earned by consumers is not taxed away or saved, it is obvious that a serious gap will exist between the power to purchase and the supply of goods.

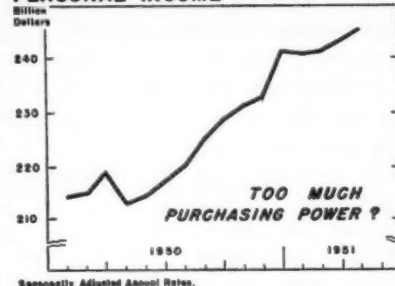
FEDERAL CASH INCOME AND OUTGO



In these circumstances, strong upward pressure on prices will result in the absence of adequate counter measures. Higher taxes and vigorous credit restraints are an essential part of this program. The greatest present

danger stems from the tendency to take a complacent attitude toward the future during the present transitory period of stable prices. In approaching the problems of the second post-Korea year, however, the nation may be heartened by the achievements of the past 12 months. Significant increases in production were realized, the price upsurge was curbed, and substantial progress was made toward strengthening the armed forces.

PERSONAL INCOME



Deposit Ownership Shifts Reflect Post-Korea Business Expansion

Demand deposits of individuals and businesses in Seventh District banks rose by more than one billion dollars in the 12 months ended January 31, 1951. This was the largest dollar gain in any postwar year and brought the total to a new peak of 13.7 billion. The District growth in privately owned demand deposits was 8.6 per cent, moderately more than the 7 per cent gain experienced by banks in the nation as a whole. In contrast to the smaller 1949 growth, which largely reflected bank purchases of Government securities, the 1950 rise resulted primarily from the unprecedented post-Korea expansion in bank loans.

At the end of January every type of privately held deposit exceeded year-ago levels, according to the latest annual estimates of deposit ownership made by the Federal Reserve Bank of Chicago. Accounts of *business firms*, however, made larger relative gains (9.5 per cent) than did deposits of *individuals* (7.8 per cent). The survey also indicates that larger banks—where business deposits comprise a much greater portion of the total—reported heavier gains than did smaller banks. This relative shift from individual to business ownership during 1950 continued the trend of the past four years. This was true both for Seventh District banks and for the nation as a whole.

Although smaller than the relative gain in business deposits, the expansion in *personal deposits* was far greater than that of the previous year. This reflects the sharp growth in personal incomes in 1950, which was only partly absorbed by increased consumer expenditures and additions to individual holdings of interest-bearing liquid assets.

Among nonfinancial businesses, "manufacturing and

mining" accounts experienced the largest percentage gain—over 12 per cent. Since these accounts constitute more than one-fourth of District banks' total private deposits, their growth contributed significantly to District deposit expansion. The 1950 increase was the largest gain for manufacturing and mining firms in any postwar year. As might be expected, these accounts are concentrated in big banks, particularly in Chicago and Detroit, but banks of all sizes throughout the District reported sizable percentage gains in them. The rise in manufacturing and mining deposits reflects increased profits and substantial new borrowing and security financing on the part of these businesses, together with a tendency to hold larger working balances in the face of rising costs and the probability of further expansion in defense operations.

Deposit accounts of *retail and wholesale trade* establishments rose by less than five per cent in 1950, considerably less than the average growth in the deposits of all businesses. The relative gain was somewhat larger at the bigger banks in the District, but only in the city of Detroit was it important. The gain in trade deposits was greater than in the "recession" year of 1949. It was less than might have been expected, however, in the light of the heavy expansion of retail and wholesale sales in 1950. Particularly after Korea, many trade firms used their higher inflows of cash to finance additions to inventory rather than to build up bank balances.

A detailed report of the 1951 deposit ownership survey is being prepared by the Federal Reserve Bank of Chicago. Copies will be available upon request to the Research Department.

The Stockpile—Umbrella for a Rainy Day

But It Is Hard to Forecast the Weather

- U. S. dependent on imports for many critical materials.
- Major stockpiling problems — where to buy, when to sell.
- Stockpile increase tenfold since 1946.

Scattered throughout the United States are great caches of vital raw materials. Aluminum, cobalt, copper, manganese, and mica are to be found here. These, plus over 60 others, are the American stockpile, a vast hoard of strategic and critical materials valued at nearly three billion dollars. The outbreak of hostilities in Korea a year ago underscored the nation's need for such reserves of materials vital to defense.

One of the most startling features of the past twelve months was the phenomenal 47 per cent rise in basic commodity prices. This rise occurred between June 1950 and February 1951 when several of these commodities were being stockpiled. This price advance and the development of scarcities resulted in criticism of the stockpiling program in general. A look at the history, objectives, and problems of the program is needed in order to evaluate these criticisms, however, since most of the Munitions Board's policies can be explained only in the light of these factors.

Stockpiling the Result of Past Shortages

The United States is almost completely dependent upon imports for many of the most vital raw materials. For example, imports account for 100 per cent of the tin and chromite, about 95 per cent of the nickel and cobalt, and over 90 per cent of the manganese consumed by American industry. The points of origin of most of these minerals are such distant spots as the Belgian Congo, India, South Africa, the Philippines, and Indonesia. A steady stream of these imports is necessary if American industry is to function and defense production is not to be hampered by shortages. For example, metals vital to the production of a J-34 jet engine include aluminum, chrome, cobalt, columbium, copper, manganese, molybdenum, nickel, and tungsten. Each is classified as strategic or critical and currently is being stockpiled.

Most of the supply lines over which these minerals travel have been difficult to maintain during hostilities in the past and would be again in the future. Recognition of this vulnerability occurred during World War I as a result of upset production schedules and delayed procurement of armaments. World War II shortages of rubber and other important materials, however, brought about more vigorous attempts to build up a stockpile of

potentially scarce, vital goods.

To prevent a recurrence of the shortages of World War I, a list of 42 materials was drawn up by the Army General Staff in 1921. It included materials which the Staff felt would be hard to obtain during subsequent periods of emergency. Only 13 of the items on this list appear on the current one. Uranium, which appeared on the former, is not included today.

As the outlook in Europe darkened toward the end of the 1930's, the Army and Navy Munitions Board increased pressure for some kind of accumulation of vital imported raw materials. The Stockpiling Act of 1939 was the result. This legislation authorized 100 million dollars for stockpiling purposes.

As World War II approached, larger appropriations were made and procurement activities were broadened. However, the amount of stockpiling which actually occurred under this law was relatively small. The urgency of the situation was not sufficiently comprehended and the authorities carried on only halfhearted efforts to build a stock of materials. In 1940, the Reconstruction Finance Corporation was given authority to "produce, acquire and transport materials for defense;"

1946 Act Sets Current Policies

The most important stockpile legislation is the Strategic and Critical Materials Act of 1946. This Act represented the nation's first wholehearted effort to stockpile. It removed the limit on the amount of funds which could be appropriated by Congress for stockpiling purposes and presented more specifically and clearly than before the need for this type of activity. To be eligible for hoarding under this Act, materials have to fulfill four criteria. They must be "essential for the common defense, insufficiently available in the United States, capable of being stockpiled, (and) . . . must eliminate or reduce a dangerous and costly dependence on some foreign nation." In addition, the Act of 1946 provided for research to discover substitute materials and to develop new sources of supply.

The Munitions Board is the central staff agency of the stockpiling program and is in charge of coordinating the activities of all the other participating agencies. In addition, it represents the National Defense Establishment in policy making. The Bureau of Federal Supply is the procurement agency, making the actual expenditures authorized by the Munitions Board. The Economic Cooperation Administration lends funds where there is a possibility of developing new sources of stockpilable materials. The Department of State assists in technical matters and the Department of Commerce provides information as to current and expected demand

for strategic and critical materials. The Department of the Interior helps to set goals, provides statistics, and carries on research to develop substitutes for critical materials. The Department of Agriculture supplies statistics and helps procure materials in exchange for agricultural surpluses shipped abroad.

Based on 1950 prices, the value of the completed stockpile is to be almost nine billion dollars. This compares with an objective of 4.7 billion dollars in 1946. Stocks on hand, valued at December 1950 prices, have risen from 237 million dollars in 1946 to almost 3 billion at present, a little over one-third of the total goal.

Stockpiling Policy

From time to time since the Stockpiling Act of 1946, the Munitions Board has announced policies which, in retrospect, help to explain why the stockpile has lagged the objective considerably. In the first place, the Board tries to acquire materials at current market prices rather than to bid strongly for them. This tendency to subordinate procurement to market conditions has limited the possibilities of obtaining supplies by bringing marginal producers into production. In the slight recession of 1949, however, purchases were made where it appeared that substantial surpluses existed. Second, a "Buy American wherever possible" provision of the Act has tended to tie the hands of Board officials, since often it would have been easier and cheaper to buy in world markets. Third, the general policy of affecting the market as little as possible has tended to prevent aggressive buying in periods of high business activity. Finally, the Board has tried to make its purchases in an orderly manner.

The policy of the Munitions Board is to change objectives for individual commodities as conditions change, removing some items from the list, adding others. For example, optical glass has been deleted recently while chemical grade chromite and asbestos have been added. One of the chief aims is to maintain a balanced stockpile. For example, cobalt for special grades of steel is useless if manganese for basic steel is not also available.

Stockpilers Face Important Problems

Policy problems confronting stockpile authorities have grown in number and complexity. With strengthening demand following the outbreak of hostilities in Korea, it became more difficult to acquire strategic and critical materials without competing with domestic users and affecting seriously demand and prices in world markets. This situation was intensified by the tremendous volume of private scare buying and speculation which occurred both at home and abroad. Some European countries have been critical of recent stockpile decisions, claiming that the United States is trying so hard to become self-sufficient that the rest of the world is being deprived of its rightful share of certain commodities. That this criticism does not appear justified is substantiated by the fact that, after allowance for price increases, imports of many critical materials have declined.

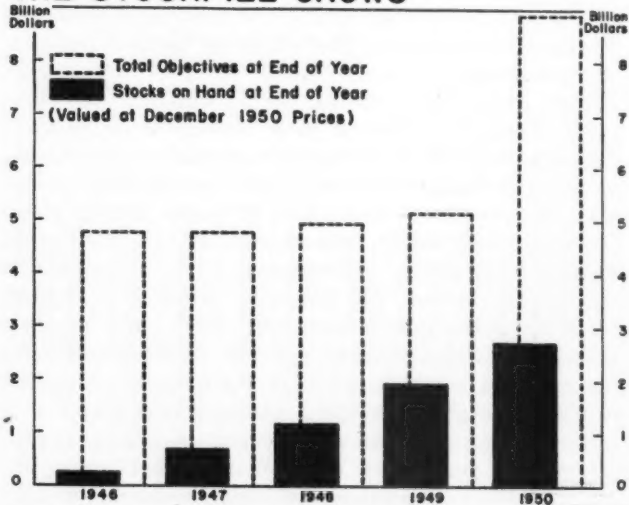
Despite recent growth, the total stockpile is not significantly closer to its objective than it was three or four years ago, even though at the end of 1950 an average of over 40 million dollars per month were being spent to build it up. This apparent contradiction is caused by the fact that since 1940, the goal has been raised several times until it is now three times what it was five years ago.

Speculation in many metals is based in part upon the assumption that since the stockpile needs materials it will pay high prices for them. This feeling is not so strong as it was before March 1951, however. In that month, without warning, stockpiling officials withdrew from the tin market. Tin prices promptly fell 30 per cent.

None of the problems facing stockpile authorities is more knotty than that of deciding how and when to dispose of stockpiled items as individual objectives are attained. Several materials are no longer being stockpiled because substitutes or new sources of supply have reduced the dependence of the U.S. on imports, or because stockpile objectives for particular commodities have been attained. As more of these individual goals are reached, disposal of materials will tend to become the chief problem of stockpiling officials. This will be especially important in periods when business is operating below capacity and prices are declining.

All in all, the stockpiling program is making a vital contribution to the defense effort. Policies of the Munitions Board may have been, in retrospect, something short of perfect, but the idea of stockpiling is a good one. It is generally recognized that the accumulation of materials for a stockpile has the same inflationary effects on business conditions as the accumulation of private inventories; the release of materials, the same deflationary effect. Although this will be a continuing problem in the management of a stockpile, it should not divert attention from the development of an adequate inventory of vital materials designed to make a National emergency less acute should it occur and which may even be an important factor in preventing it.

THE STOCKPILE GROWS



Source: Stockpile Report to the Congress, January 1951.

Quick Write-Offs Aid Expansion

Bulk of Permits to Basic Industries

- New defense-connected facilities to be depreciated over five year period.
- More than six billion dollars of projects already approved.
- Program criticized for reducing Government revenues.

A substantial portion of the cost of the great expansion plans now under way in most major industries will be written off for tax purposes within five years after completion. Acceleration of depreciation encouraged the construction of new facilities by private firms during World Wars I and II. Now, this device is expected to help achieve the Government's goal of sufficient capacity in 1953 to carry the heavy burden of rearmament plus near-record civilian consumption.

Who Gets the Certificates?

Quick write-offs are attractive to most business firms in a period of high earnings and high corporate tax rates if it is expected that rates will be lowered in the future. Only those new projects which are approved by the Defense Production Administration (DPA) qualify for this privilege. Officials state that certificates of necessity are restricted to new facilities which will aid the mobilization effort directly or indirectly.

Only in a few special cases will industry be permitted to write-off the entire cost of a new facility within five years. The remainder must be depreciated over the probable life assumed for a similar facility under normal conditions. The percentage allowed under certificates issued so far varies between 40 and 100 per cent with the average about 70 per cent. In the case of specialized machine tools for the production of war materials a 100 per cent write-off may be permitted while a utility or paper mill may be allowed only 50 per cent.

Plant and equipment specifically intended for the manufacture of planes, ordnance, or other military goods should obviously be amortized over a period approximating the duration of the emergency. However, current policy calls for the expansion of basic industry which produces materials or services used in final products for both war and peace.

Through June 8, 1,766 investment projects totaling 6.2 billion dollars were approved for accelerated depreciation out of 17.5 billion of applications. Only about 10 per cent of the approvals are for the production of finished goods including military supplies. Since steps have been taken by the National Production Authority to forbid the construction of nonessential projects, any licensed project would appear to have some claim to considera-

tion for rapid amortization. This fact increases the problems of officials who determine which applications merit approval. Standards used by DPA officials in granting certificates to particular projects include the following: (1) the degree of urgency, (2) expected usefulness after the emergency has passed, and (3) incentive needed to assure that the investment will be undertaken. The main advantage of the program to a firm is, of course, the anticipation of tax savings, but there are other benefits. Possession of a certificate of necessity facilitates the process of obtaining a loan from a Government agency or a private financial institution since it is evidence of the essential nature of the project involved. In addition, the five year period during which a firm is permitted to "recover the cost" of new facilities suggests that use may be made of term loans from commercial banks in this connection.

Basic industries such as iron and steel, nonferrous metals, chemicals, petroleum refining, and transportation have received a lion's share of the certificates of necessity issued so far. Of these groups, iron and steel alone accounts for 37 per cent of the total. However, the steel firms put their bids in early and received prompt attention. At the end of January, steel firms accounted for over 80 per cent of the total. Certificates have now been granted for most of the iron and steel and petroleum refining expansion originally contemplated.

In recent weeks a large portion of the certificates have gone to railroad firms for equipment. Future increases in the total of certificates granted will probably center in the chemical, aircraft, and ordnance categories.

The Program Has Critics

Rapid amortization has been the center of a heated controversy. The program and the method of its administration have been attacked vigorously for reducing Government revenues, for contributing to inflationary pressures, and for aiding big business. W. H. Harrison, former DPA administrator, has defended the program by stating that "emergency amortization is one of the soundest instrumentalities of Government to encourage expansion of industrial strength for national security." Other Government officials and some private individuals are not so sure. Few question the fact that quick write-offs have played a part in encouraging private industry to undertake additional expansion programs. However, several Congressional committees have called upon the administrators of the program to account for their actions.

The matter of small business not receiving its share of the authorizations appears to be an invalid criticism since the type of expansion which the Government seeks

to encourage is usually undertaken only by large firms. The important questions are (1) would not a substantial portion of the desired expansion have been undertaken without accelerated depreciation and the possible resultant loss of Government revenue and (2) are these programs overambitious during a period in which inflationary pressures are almost certain to mount? Those who have been responsible for the administration of the program reply that the type of expansion covered by certificates involves only the most essential type of facility, and that the decision as to whether a special incentive is necessary must be a matter of judgment.

Secretary of the Interior Chapman is one of those who take a dim view of allowing accelerated depreciation on most types of industrial expansion. The Interior Department's Defense Power Administration recommends action on applications for electric power projects. In most cases, only 50 per cent, five year write-offs are proposed but Chapman thinks this is too liberal. He believes most of the projects would be undertaken in the absence of special incentives and that accelerated depreciation should be strictly reserved for defense facilities which will have little or no usefulness in the post-emergency period. Utility executives contend that they need rapid amortization to compensate for high current costs, restrictions which prevent the most modern type of equipment from being installed, and the greater difficulty of financing expansion this year.

Accelerated Depreciation in World War II

Under the Revenue Act of 1940, defense-connected facilities could be written off within five years or in a shorter period depending upon the duration of the emergency. The method of granting certificates of necessity was similar to that now in use. In fact, the regulations governing the administration of the present program are merely an amended version of those in effect during World War II.

Of the 23 billion dollars worth of defense plants built during the 1940-45 period, 17 billion were Government owned. Only four billion dollars worth of private projects were granted certificates permitting accelerated depreciation and almost all of these were instituted prior to the end of 1942.

The dollar value of facilities for which certificates have been granted during the past seven months already exceeds substantially the total approved in the five years of the World War II emergency. This volume may be expected to grow considerably since the Government plans to leave most of the emergency expansion in the hands of industry and private financial institutions. Business is more willing to undertake this task than it was during World War II because (1) there is more confidence in post-emergency demand and business is in a stronger financial position, (2) a larger share of the expansion is for basic capacity which can be used to satisfy civilian requirements, (3) proposed facilities are being planned and located with less haste, and (4) business managers prefer to see the new industrial plants in private

hands. There is good reason to believe that if industry did not proceed with the expansion now contemplated that the Government would build the facilities itself. Under these circumstances it is possible that most of the new private capital expenditures would be undertaken even in the absence of special inducements such as rapid amortization.

The most serious objections to the program are those which relate to the inflation problem ahead. Accelerated depreciation will cut Government revenues substantially (perhaps by over 500 million dollars per year). In addition, the expansion plans now in the planning stage will reduce the materials available for the production of finished goods. If these supplies were used in the output of armaments or consumer goods, the inflation threat which will accompany the step-up in military expenditures as the year progresses could be moderated.

Effect on Taxes and Profits

The immediate effect of faster amortization of new fixed assets will be to decrease a firm's profits and taxes, and to increase the cash at the disposal of its management. The process is especially advantageous to a firm with an unfavorable excess profits tax base because of low earnings in the 1946-1949 period or a small investment. If the assets covered prove to be of use in making income for business after the five-year period has elapsed, the process will begin to work in reverse since no more depreciation can be taken after the original cost has been "recovered."

In general, rapid amortization will reduce profits and taxes in the early years of an asset's life and increase them in later years. The main impact of the new program upon the financial position of business will be that additional cash represented by tax savings will find its way, temporarily at least, into business coffers. Since few firms keep separate depreciation reserve funds in cash or securities, the money is available for general business uses.

For many firms the availability of this cash will obviate the need for additional outside financing. Others may employ the money to repay debts, increase wages and salaries or dividends, or to build up a cash reserve. The pressure for additional payments to employees and stockholders should not be particularly strong since profits will be lowered.

Depreciation is not a large item compared to other corporate expenses. For all manufacturing firms in 1950, depreciation and depletion amounted to only a little over two per cent of sales. Even in the case of such heavy manufacturing industries such as steel, depreciation is not likely to be much above five per cent of sales. However, the importance of depreciation lies not in its magnitude compared with other expenses, but in the fact that it represents funds retained in the business rather than money paid out. The more valid comparison is with profits. Some firms have obtained certificates for new projects which will result in additional depreciation expense equal to 1950 profits.

NEW CAPITAL NEEDED IN SOIL IMPROVEMENTS

(Continued from Inside Front Cover)

acre. Two-thirds of the per acre costs were for lime, phosphate, fertilizer, and water disposal while the remainder was for buildings, equipment, machinery, and livestock to utilize the increased production of roughage. The additional yearly income of \$8.27 per acre was sufficient, however, to recover the investment in four years.

Ten years of records on McLean County, Illinois, farms indicate that benefits from a good soil management program increase from year to year. Farms on similar soil types were studied by University and Soil Conservation Service specialists. These were divided into two groups according to the amounts spent for soil improvements. In 1936 when the study was getting under way, net income for both groups of farms was about the same. However, the 1936-40 average income per acre for the group with the greater investment in soil improvements was \$2.36 per acre higher; for the 10 year average (1936-45) it was \$3.46 higher (see accompanying chart).

Studies in Wisconsin indicate that measures to retard soil erosion need not be expensive or time consuming. For example, costs of various types of terraces ranged from about four to eight dollars per acre. The hours of labor per 1,000 feet of terrace ranged from about four to fourteen (see accompanying table). Crop yields were from 10 to 15 per cent higher on terraced than on unterraced land. Assuming no yield advantage for the first year, terraces more than paid for themselves in three years.

Since the evidence indicates that investments in improved soil management practices are profitable, why are such practices not adopted more rapidly? Some farmers feel that making additional investment in their land would retard present debt retirement schedules. Others may be reluctant to encumber land owned clear of debt. The changes frequently would reduce income temporarily. This complicates the financial problem and increases the reluctance to make the investment even though longer-run income prospects would be greatly improved. Fortunately, on most farms in the Seventh District soil investments can be started modestly, progressing on a field by field basis if necessary until the entire farm is covered. If desired, livestock can also be expanded gradually as funds and skills in handling are required.

TERRACE CONSTRUCTION COSTS 139 WISCONSIN FARMS, 1949-50

Item	Regular Terraces			Diversion Terraces	
	Hired Public Equipment	Farm Tractor ¹ and Plow	Whirlwind Plow	Hired Public Equipment	Farm Tractor ¹ and Plow
Number of farms.....	95	18	8	13	5
Lineal feet per farm....	4,210	2,076	4,535	1,042	705
Hours per 1,000 feet....	3.1	9.6	5.5	6.3	13.9
Costs per 100 feet.....	\$1.36	\$1.45	\$2.08	\$2.38	\$2.27
Costs per acre.....	\$4.54	\$3.80	\$7.87	—	—

¹Farm tractor costs estimated at \$1.50 per hour.

SOURCE: U. S. Soil Conservation Service and the Wisconsin Agricultural Experiment Station.

Financing Soil Improvements

Normally, few farmers possess sufficient funds to install a complete soil improvement program at one time, and unless soil conditions are extremely serious they usually should not attempt to do so. Careful appraisal of the farm needs, deciding on the over-all program, and following through with its gradual development as time and capital resources permit probably is the best procedure on most farms.

Many plans have been suggested as a basis for financing soil improvements. It is generally proposed that loans be based on the amount needed to carry on the work outlined in a complete soil improvement program, and disbursements made over a period of several years as individual jobs are undertaken. Repayments are commonly scheduled in accordance with the anticipated increase in income resulting from the investment made. The real estate normally serves as security for the soil improvement loan leaving the farmer's machinery, feed, and other capital free for other operating credit needs.

Some lenders hesitate to make a formal commitment for a complete program extending over several years. Likewise, some farmers are not willing to commit themselves to a complete program for the whole farm. In these instances a series of more limited agreements involving specified jobs and relatively short-term loans may be worked out satisfactorily. The lender and borrower should have a complete plan made, however, and consistently work toward this longer term goal.

It should be emphasized that many needed soil improvements in the Seventh District states can be made with relatively short-term loans. A typical example would be a loan to purchase fertilizer needed to obtain maximum production from high yielding varieties of hybrid corn. Practices of this type give prompt financial returns and should be encouraged in the present situation to provide needed increases in production. This, in no way, belittles the importance of measures providing slower financial returns and which frequently are of importance in the long run. Practices providing prompt returns, however, will help provide capital needed for improvements.

Some lenders emphasize that properly planned and serviced soil improvement loans are a type of farm mortgage financing that adds to the real value of the security while the principal indebtedness is being reduced. This type of financing overcomes one of the major weaknesses of conventional mortgage credit in which the lender has no control over the use or maintenance of the land which provides the security for the loan.

A large amount of additional capital could be invested profitably in soil improvements in the Seventh District states. Banks and other institutions not now making such loans might investigate local needs and consider the development of workable procedures for financing this kind of capital investment. The effective use of credit for this purpose should work to the advantage of both borrower, lender, and the community, and it would assist in the maintenance of highly productive soil resources on a permanent basis.

The Trend of Business

War Orders Begin to Take Hold

The nation's productive machine is swinging into the expanding rearmament effort with remarkable smoothness. Substantial restrictions in the use of strategic materials in the July-September quarter have been announced, but the immediate effect upon manufacturers will be softened by lagging consumer demand and bulging inventories. Some layoffs have occurred in Seventh District plants but steadily growing defense activity should gather up any slack which may develop. Apparently, 1951 will not see a serious "conversion recession" or "inventory slump" as was predicted in many quarters early this year.

Contracts awarded by procurement agencies continue to flow to plants in this area. Although total business loans of District banks have been relatively steady since early March, loans to defense contractors recently have been moving upward at a rapidly accelerating rate. There has also been a sharp upswing in applications for V-loan guarantees.

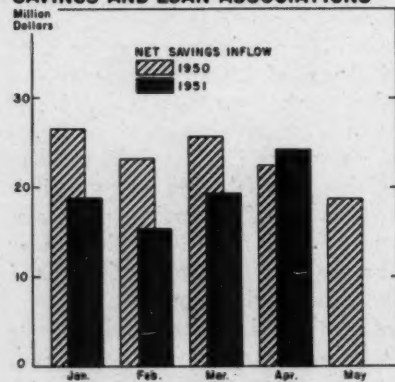
By far the largest number of defense contracts are for everyday goods which can be produced without re-vamping production lines. The big items, however, are the military hard goods—tanks, planes, vehicles, and ordnance. Automobile firms have a seven billion dollar backlog of orders for goods of this type. Most of this material will be produced in plants located in Michigan, Indiana, and Illinois. These contracts usually require a lead time of 12 months or more, even if an existing plant is used.

New plant construction will employ a larger share of available materials in the months ahead. Contract

awards for new factories in the Seventh District, reported by F. W. Dodge, total 158 million dollars during the first four months of this year compared with 67 million in the comparable period of last year.

Some important defense plants will be built from scratch, particularly for the manufac-

SAVINGS AND LOAN ASSOCIATIONS*



* Insured Associations, Seventh District States.

ture of jet engines. Among these are large factories to be built by Buick (Chicago area), Chrysler (Detroit area), and Packard (Utica, Michigan). These three alone will involve the expenditure of over 100 million dollars.

Total production of civilian durable goods remains at high levels despite reductions in the output of some

items. Television sets are being turned out at a rate two-thirds below that of last fall. Most of the automobile companies laid off workers either indefinitely or for periods of a week or more as a result of parts shortages or slower sales. Manufacturers of refrigerators, stoves, and washing machines have also reduced output substantially.

Output of steel, the most basic raw material, sets new records almost weekly. In June, the United States Steel Company plant at Gary scheduled production at 107 per cent of rated capacity. However, the current rate of output is threatened by a serious shortage of heavy melting scrap.

The tight labor market in District centers continues. Unemployment claims in Illinois are at their lowest level since 1946. Indications are, however, that the heaviest demand for defense workers will not occur until the first quarter of 1952.

Inventories in the hands of retailers are still high relative to current sales, but anxiety over this problem has relaxed somewhat. Nevertheless, the Chicago Association of Purchasing Agents reports a distinct slackening in forward buying and ordering which will probably continue as long as retail sales remain at present levels. The absence of price cutting activity in District cities, following the Supreme Court decision which emasculated existing price-fixing laws, may indicate that the inventory burden is not as serious as had been supposed. The problem of excess television stocks has been alleviated to some extent for trade firms by manufacturers' price cuts, introduction of new models, special sales promotions, and, in certain cases, auction sales.

Savings are on the rise once again as incomes edge upward and consumer buying remains at a moderate level. The net in-

flow of funds to District savings and loan associations and bank savings accounts in April compared favorably with a year ago despite the influence of the large rebates on GI life insurance granted last year. May and June witnessed similar accumulations. Record consumer income and

liquid asset holdings could easily support a third buying wave if fears of shortages and price increases are revived.

MANUFACTURING BUILDING AWARDS*



* In an Area Approximating the Seventh District.
Source: F. W. Dodge Corporation.

